COUNCIL AGENDA: 12/16/2014
ITEM: 4.3

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Kim Walesh, Jennifer Maguire

SUBJECT: SEE BELOW

DATE: November 24, 2014

Approved [signature] Date 12/4/14

COUNCIL DISTRICT: 3

SUBJECT: APPROVAL OF ACTIONS RELATED TO SALE OF CITY-OWNED PROPERTY AT 1123 COLEMAN AVENUE TO COLEMAN AIRPORT PARTNERS AND RELATED APPROPRIATIONS

RECOMMENDATION

(a) Staff recommends City Council adopt a Resolution approving the following actions:

(1) Approval of Second Amended and Restated Option Agreements and Purchase Agreements amending the terms of the existing option and purchase and sale agreements with Coleman Airport Partners LLC (Developers) to allow a two phase sale of the 42 acres of Airport West property located at 1123 Coleman Avenue;
(2) Approve Amended and Restated reciprocal easements required to facilitate access and circulation over the property;
(3) Approving a right of entry for the development of certain proposed streets on property owned by the City;
(4) Approve repayment plan with the United States Department of Housing and Urban Development (HUD);
(5) Authorize the City Manager to Negotiate and Execute Funding Agreements with the Valley Transportation Authority and the Developers to build the Caltrain Tunnel Connection on the property; and
(6) Authorize First Amendment to the Parking Agreement Between the City and the San Jose Earthquakes, LLC.

(b) Adopt the following 2014-2015 Appropriation Ordinance and Funding Sources Resolution amendments in the General Fund:

(1) Increase the estimate for Other Revenue by $39,525,562;
(2) Increase the appropriation to the Finance Department for FMC Debt Service Payments in the amount of $33,552,562;
(3) Establish a Capital Improvement appropriation to the Office of Economic Development for the Airport West Property Caltrain Connection in the amount of $5,973,000;
(4) Reduce the Airport West Property Sale Reserve in the amount of $1,000,000; and
(5) Establish a Capital Improvement appropriation to the Office of Economic Development for the Airport West Property Underground Abatement in the amount of $1,000,000.

OUTCOME

Adoption of these recommendations facilitates development of a unique job center and amenity rich location directly adjacent to the Norman Y. Mineta San Jose International Airport, Caltrain Station and the Earthquakes stadium, Santa Clara University and near both North San Jose and Downtown. The proposed actions to allow the phased sale of the property would facilitate the immediate development of 320,000 square feet of Office/R&D, up to 12,500 square feet of retail and a hotel. Near-term development on site is anticipated to capitalize on existing market activity and accelerate development on the remainder of the site. Development of the site will create a unique transit-oriented destination in San Jose, increase the community's job base and generate new one-time and ongoing revenue for the City.

EXECUTIVE SUMMARY

The City has purchased the Airport West property located at 1123 Coleman Avenue in 2005, partially with a HUD Section 108 loan. The original intent for purchasing the 75 acres from FMC, Inc. was to facilitate Airport construction and economic development. In May 2008, City Council approved an MOU with Coleman Airport Partners and FWSH Partners that outlined the price, option period, and uses on the property. As the economy and real estate market became challenging and use needs changed, the City Council has modified the option agreement several times since 2008. All along, City staff has strived to turn challenge into opportunity and capitalize on a unique business location that is adjacent to the Airport, Caltrain, a future BART station, and at the Gateway to Downtown and North San Jose.

The Airport West property was purchased in two phases with a combination of proceeds from lease revenue bonds issued by the City of San Jose Financing Authority and a loan from HUD. The City has previously entered into option agreements for the sale of portions of the Airport West property with FWSH Partners, LLC and Coleman Airport Partners LLC.

FWSH Partners exercised its option to purchase the portion of the Airport West Property. This portion of Airport West site now is home to a $100 million Major League Soccer stadium under construction for the San Jose Earthquakes Soccer, sponsored by Avaya and other major sponsors. Adjacent to the Earthquakes stadium on the portion of the Airport West to remain under City ownership will be a City public soccer complex that will complement the Earthquakes Stadium.

The City's soccer fields will be operated by the Earthquakes under a qualified management agreement with the City.

Approximately 42 acres of the Airport West property is under an option agreement for the purchase by Coleman Airport Partners LLC ("CAP" or the "Developers"). CAP and City staff propose to amend the existing option agreement in order for the Developers to purchase the property in two phases, or tranches, instead of a single purchase as currently specified in the option agreement.

The Developers plans to develop approximately 1.5 million square feet of office/R&D, two hotels and up to 50,000 square feet of retail. The First Tranche of development will hold 320,000 square feet of office/R&D, one hotel and up to 12,500 square feet of retail. Under the proposed terms of the amended option agreements, the Developers will pay approximately $41 million for approximately 23 acres in the first tranche.

As previously approved by Council, the City will apply $5 million in prior option payments as a credit towards the purchase price. As a result, the City will receive approximately $36 million from the sale of the first tranche of property from the Developers. The application of the proceeds of the sale of the first tranche toward partial repayment of the HUD loan and the lease revenue bonds that financed the City's purchase of the Airport West property, as well as an advance for the Developer's contribution to support a connection to the nearby Caltrain station, are described in the Analysis and Cost Summary/Implication sections of this memorandum.

The critical pedestrian tunnel connection needed to link the development site and stadium/soccer complex to the Santa Clara Caltrain station is estimated to cost almost $14 million. The Developers have agreed to pay $6 million toward the costs of constructing the tunnel connection. The Valley Transportation Authority staff is proposing to the VTA Board on December 11, 2014 that the VTA fund $7.8 million to complete the tunnel. VTA has requested that the City enter into a funding agreement with VTA to fund the Caltrain site. Staff is requesting that the City Manager be delegated the authority to negotiate and execute the necessary agreements with both VTA and the Developer. The City will not be responsible for any funding overruns associated with the construction of the tunnel. City staff is proposing that the City advance $2.5 million of the Developer's obligation toward construction of the tunnel. Staff has negotiated with HUD to allow the City to retain $2.5 million from the sale of HUD financed portion of the first tranche. Under the negotiated terms, the City will repay HUD either when the Developers purchase the remaining Airport West property or over a period of five years.

In the first tranche the City will also reimburse the Developers for up to $1 million for the removal of hazardous materials and substantial underground structures from the former FMC plant. This amount can be covered with the $1.0 million Airport West Property Sale Reserve that was established in 2013-2014 with the receipt of a previous option payment received by the City.

Under the proposed terms of the amended option agreement, the Developers option to purchase the remaining Tranche 2 of land or roughly 19.1 acres of land expires on December 31, 2017.

When the Developers purchase tranche 2 for approximately $30 million, the Developers will repay the first $1 million toward the $2.5 million advanced by the City for the Caltrain tunnel connection. Upon obtaining building permits for the first building to be constructed on Tranche 2 the Developers will be obligated repay the remaining $1.5 million owed for the Caltrain connection.

HUD requires that 51% of jobs generated from properties that are financed through HUD loans be of low or moderate income. The Developers have agreed to cause their tenants to provide the necessary job information until six months past such time that the buildings on the 8.9 acres of HUD financed land are fully occupied.

City staff is also coordinating with Bank of America, which owns the lease revenue bonds used to finance a portion of the Airport West property. Bank of America had previously consented to the sale of a portion of the first tranche of the Airport West property, if the closing was completed by December 31, 2014. Staff has requested and received a 90 day extension of the bank's consent.

BACKGROUND

In 2005, the City of San José (the "City") purchased the 74.8 acre property located at 1125 Coleman Avenue from FMC. The property is now known as the Airport West property. The City's intent was to purchase only 51.6 acres of the property to support the Airport expansion program. FMC was unwilling to sell the City only a portion of the site. In order to assist the Airport construction, the City acquired the additional 23.2 acres. To finance the acquisition of the 23.2 acres, the City entered into a Housing and Urban Development (HUD) Section 108 loan in the amount of $25,810,000. The City also applied for and received a $2 million Brownfields Economic Development Initiative (BEDI) grant to help defray initial interest payments. To finance the acquisition of the 51.6 acres the City of San José Financing Authority (the "Authority") issued $80,025,000 of lease revenue bonds (the "2005 Bonds"). As a result of the economic crisis in 2008 the Authority refunded the 2005 Bonds in 2008 with the Series 2008F Lease Revenue Bonds (the "2008F Bonds").

The 51.6 acre portion of the Airport West property acquired with the 2005 Bonds was used by the Airport for construction lay-down and other Airport uses through fiscal year 2010. With the substantial completion of the Terminal Area Improvement Plan (TAIP) in fiscal year 2010, the Airport's use of the Airport West property terminated as of June 30, 2010.

Subsequent to the City's acquisition of the Airport West property, the City received a proposal from Coleman Airport Partners, LLC ("CAP" or the "Developers") and FWSH Partners, LLC for the development of all of the property except 9.3 acres reserved by the City for a BART maintenance facility. In May 2008, the City Council approved a Memorandum of Understanding (MOU) between the City, FWSH Partners LLC and Coleman Airport Partners LLC that outlined the price, option period and uses on the Airport West property.

Due to the different financing structures related to the HUD loan and the 2008F Bonds and the uses of the properties, on July 24, 2008, the City entered into three separate option agreements for the sale of the Airport West property with the FWSH Partners and the Developer. The City and the Developer entered into two option agreements. The first option agreement is for the "Development Site" which includes approximately 42.1 acres and the second option agreement is for the "HUD Commercial Site" which includes approximately 8.9 acres, totaling 51 acres. The third option agreement was between the City and FWSH Partners for the "HUD Stadium Site" which is approximately 14 acres.

On May 5, 2009, the City Council approved amendments to the Development Site and HUD Commercial Site Option Agreements. The amendments reduced the purchase price and option payments to be paid by the Developer and extended the option period on the HUD Commercial and Development sites until 2015 in recognition of the economic downturn and its impact on the value of the property.

In 2009, the City was informed that BART no longer needed the 9.3 acre portion of the Airport West property located at the rear of the property adjacent to the railroad tracks. On June 23, 2009, Council approved a Memorandum of Understanding (MOU) with Earthquakes Soccer, LLC to develop a 2.6 acre practice field for the Earthquakes soccer team on a portion of the 9.3 acre site. On January 25, 2010, the City and Earthquakes Soccer, LLC entered into a lease for the soccer practice field. The lease payment for the soccer practice fields is $24,000 annually.

On November 7, 2012 FWSH exercised its option with the City to proceed with development of an 18,000 seat Major League Soccer stadium for the Earthquakes. In early 2011, staff from the Parks Recreation and Neighborhood Department and the Office of Economic Development worked together to find a site for the Measure P soccer complex. The soccer complex was one of two remaining facilities needing a location to conclude the work of the Measure P bond. Staff recognized that a soccer stadium, in conjunction with commercial activity, could be a successful economic development activity for the City and a synergistic recreation venue with the Major League Soccer stadium.

Developing a site plan for the community soccer facility required changing land allocations on site. To provide enough land for the soccer facility it was necessary to reduce the size of the Development site by 7.5 acres. Partially offsetting the reduction in acreage for the Development Site, the Developer agreed to purchase an additional 1.843 acres of land adjacent to the existing Earthquakes practice field. The net impact of the changes resulted in a reduction in possible sale proceeds of $10.08 million. The City would also retain 14.97 acres of land including the San Jose Earthquakes practice field and the community soccer fields (Attachment A).

On May 29, 2012, the City Council approved inclusion of the City soccer fields at the Airport West site. The design and construction costs associated with these soccer fields were funded by Measure P. Extensive work was done by City staff to facilitate the financing of the proposed soccer fields at the Airport West site. A summary of the Source and Use of Funds for the current standing of the Airport West Property is included as Attachment B.

ANALYSIS

In late 2010, Silicon Valley began its economic recovery and companies throughout the Valley began adding headcount. Traditionally, economic recovery in Silicon Valley begins on the Peninsula closest to Palo Alto. The current economic and job recovery focused on the Peninsula and on San Francisco. Development activity then spreads south, down the Valley, particularly for tenants looking for larger land area. Rents are approximately $5.14 per square foot per month in San Francisco for class A office/R&D and $8.45 per square foot per month in Palo Alto. Asking rates for class A office space in San Jose average $2.90 per square foot per month. Year over year, construction material costs throughout the Bay Area rose approximately 8-10% in light of increased demand for large projects like the new Apple, Jay Paul, Facebook and Google campuses. Much of the construction activity occurring currently is existing tenants driving new construction or tenant improvements. Legacy Partners has recently obtained building permits for approximately 300,000 square feet of speculative development in North San Jose. Other Developers such as Lowe Enterprises, Boston Properties and Ellis Partners are building speculatively and are investing in entitlements to entice tenant commitments prior to commencing with building.

CAP, led by Deke Hunter and Ed Storm, seek to move forward with speculative development on 22.815 acres of the Airport West site, after having worked with the City to overcome considerable barriers to development. Barriers included a prolonged recession, the elimination of the Enterprise Zone by the State of California, the discovery of additional hazardous materials in the form of higher levels of asbestos on site, the discovery of up to 20 foot deep foundations, HUD job counting requirements from the Section 108 funding and the need for the Developer to make a $6 million dollar contribution to the Caltrain tunnel. In addition, the CAP controlled site is required to provide 5,000 parking spaces for San Jose Earthquakes games and events.

CAP wants to capture some of the considerable Office/R&D market activity taking place to the north of San Jose and are ready to move forward with the first phase of development on the site. They believe that the Airport West site, located at the gateway to Downtown and adjacent to the Airport and the new Earthquakes stadium, with a direct Caltrain connection, will create an excellent corporate location. Further acceleration of development once the project is underway is also possible. The project is called the Coleman Highline and incorporates elements of the innovative New York Highline project. Upon completion, the office buildings will be connected by attractively designed open spaces that will foster "creative collisions" amongst office workers (Rendering in Attachment C).

<u>Current Purchase and Sale Agreement Terms</u>

Currently, the Option Agreement with CAP specifies that the Developers must purchase the full 45.4 acre development site by December 31, 2015 at a price of $35.83 per square foot or approximately $70.8 million. Under the existing terms, the Developers made an option payment of $1 million on December 31, 2013 to extend the Option until December 31, 2014. The City retained the option payment and placed this funding in an Airport West Property Sale Reserve in anticipation of additional financing requirements to close on the property and did not apply it to debt service. Another option payment of $2 million is due to the City by December 31, 2014 to extend the option until December 31, 2015, if the Developers do not proceed with purchase of the 45.4 acres by December 31, 2014. Because the Developer will not be buying the full property by December 31, 2014, the Developer will be required to pay the $2 million option payment. Under the proposed terms the Developer will get a $2 million credit towards the purchase price if the Developer closes on the property in the first quarter of 2015. Under the current documents, the City has the right to reappraise the entire property prior to a sale. If upon reappraisal the property value per square foot exceeds the agreed upon price per square foot, the City would be eligible for up to 50% in increased square foot price up to a maximum of $10 per square foot. In no event will the City receive less than the $35.83 per square foot. The proposed terms modify this appraisal calculation.

The Developers seek to change the terms of the Option Agreements to allow for the purchase of approximately 22.8 acres of the property now to take advantage of the current market demand for Office/R&D space and if Tranche 1 is acquired to extend the option period on the remaining 19.1 acres to December 31, 2017. The Developers intend to build a 320,000 square foot, six story Office/R&D building, a roughly 150 room hotel and approximately 12,500 square feet of retail space. Speculative development has associated risk, but the Developers are attempting to move forward based on their experience building @First in North San Jose and the Box headquarters development in Redwood City. CAP LLC intends to build the First Phase of Airport West and market the buildings simultaneously. Tenants prefer to engage with the Developers once they know that entitlements have been obtained and construction is underway, limiting company risk while still providing an opportunity to influence some building design and finishes.

Developer Investment

The Developers have completed zoning and site development entitlements for the first phase of development on the property. In order to move quickly and not miss current market opportunities, the Developers have begun grading and removing hazardous materials, (predominately asbestos) remaining foundations, and additional site work through a Right of Entry issued by the City. The Developers are very sensitive to market forces and want to ensure they have the best opportunity to capture a tenant for the Office/R&D component of the First Phase. Multiple hotel developers have already indicated strong interest in the site. CAP also has an excellent track record building retail and is confident about providing a successful mix of retail for the First Phase of development.

Terms for 22.81-acre First Tranche Development (Phase 1 & 2 Development)

The 22.81 acres of land encompasses the 8.479 acre remaining HUD Commercial property that the City purchased using a HUD loan and the roughly 14.33 acres of land the City purchased through the Authority. The Phase 1 Development of Tranche 1 agreement allows for 320,000 square feet of Office/R&D, a 150 room hotel and up to 10,000 square feet of development. The Phase 2 Development of Tranche 1 agreement, being the remainder of the 22.81 acre will allow 380,000 square feet of development.

Terms of the sale of the land for the First Tranche of development include:

- Gross sales price of $41.31 per square foot of land, or approximately $41.05 million dollars. To ensure that the gross sales price remains similar to the current agreement, the price per square foot is adjusted upward from $35.83 per square foot to account for the roads and other public right-of-way within the property that the City will retain.
- The sales price is reduced by a $5 million credit of applicable option payments as previously approved by City Council, or $36.05 million.
- The City proposes to reimburse the Developers for up to $1 million for the removal of unanticipated hazardous materials and substantial under-ground structures from the former FMC plant. Funding set aside in the Airport West Property Sale Reserve is available to cover this cost.
- A total of $2.5 million is proposed to be advanced by the City and reimbursed by the Developers as part of Tranche 2, Phase 3 development for the Caltrain connection. This funding would be provided by holding back a portion of the sale proceeds from the HUD Commercial Site. This amount will be reimbursed by Developers when Tranche 2 is acquired and building permits are obtained for the development on that site.
- Because the Developer will not be buying the full property by December 31, 2014, the Developer will be required to pay a $2 million option payment. Under the proposed terms the Developer will get a $2 million credit towards the purchase price if the Developer closes on the first tranche of the property in the first quarter of 2015.

<u>City Agreement with the Valley Transportation Authority (VTA)</u>

As mentioned above, currently there is no pedestrian connection between the Airport West property and the adjacent Santa Clara Caltrain Station. The site value to prospective tenants is in large part due to its proximity to Caltrain, and Caltrain access is also important for the Earthquakes soccer stadium. VTA is scheduled to commit approximately $7.8 million to building the Caltrain connection and the estimated price of a walkway tunnel is $13,725,170. The Developers are required to pay $5,973,000 for the Caltrain connection; however, VTA requires the City to enter into an agreement for the Developer's contribution. City staff proposes to advance up to $2.5 million toward the developer's portion of the construction of the tunnel connection. The City will be paid back by Developer for all dollars expended toward the tunnel connection in the Tranche 2 (Phase 3) Development as described below. The VTA is scheduled to review the allocation of funds for the Caltrain connection on December 11, 2014. It is intended that by February 2015 VTA will enter into an agreement for the $5,973,000 with the City. The City will advance $2.5 million and the Developers will initially contribute and place into escrow $3,473,000. The Option and Purchase Agreements with the Developers will include provisions requiring this initial contribution as well as reimbursement for the City's advance of $2.5 million. The VTA will be responsible for any potential cost overruns.

Inability to Close Escrow on the 22.81 acre First Tranche Development by December 31, 2014

If for any reason, the Developers and the City do not successfully close escrow on the First Tranche of Development, the existing Option Agreements for the 8.9 HUD commercial property and the 36.6 acre property will remain in place. In this instance, the Developer will pay the required $2 million option payment currently specified in the existing Agreements. Should the Developers move forward with purchasing of the First Tranche of property within the first quarter of 2015, the $2 million option payment will be applied toward the purchase price.

Terms for 19.1 acre Second Tranche Development (Phase 3 Development)

On or before December 31, 2017 the Developers may exercise their option to purchase the remaining 19.1 acre property. Terms of the sale of land for the Second Tranche of development include:

- Reappraisal – Prior to sale of the Second Tranche/Third Phase Development the property will be reappraised. As stated above, the total amount of reappraisal available to the City is recommended to be modified. If the reappraisal is higher than the purchase price of $35.83, the first $5 per square foot of reappraised value will accrue to the City, which would be approximately $4.5 million. In no event will the City receive less than the previously agreed to price of $35.83 for the Second Tranche Phase 3 development.
- At the time of sale of the Second Tranche of property, the Developers will reimburse $1 million of the City's advance for the Caltrain Connection.
- At the time the first building permit is issued for the first building of the Second Tranche/Phase 3 development, the Developers will reimburse the remaining $1.5 million of the City's advance for the Caltrain Connection.
- The Second Tranche/Phase 3 development consists of 19.1 acres and will allow roughly 800,000 square feet of development. The larger proportion of development comes as a result of tapering navigation lines related to the Airport and allows higher density on the remaining land.

Amended and Restated Reciprocal Easement Agreements

The City is entering into an Amended and Restated Reciprocal Easement Agreement whereby the City will reserve the following easements:

- Two Sidewalk Easements to provide access to the San Jose Earthquakes stadium site from the future public street fronting the stadium site (proposed Earthquakes Way) and to provide access to the Tranche One Development site from the future public street fronting the City's soccer fields site (proposed Fields Court);
- An Emergency Access Easement to facilitate access for emergency vehicles from Newhall Drive to the intersection of the future public streets fronting the soccer stadium site and the City's soccer fields site (proposed Earthquakes Way and Fields Court);

- A Public Service Easement to relocate the existing electric pole line and to provide utility service to the City's soccer field site from Newhall Drive; and
- A Temporary Access Easement to ensure access to the site of the Earthquakes practice field, located at the City's soccer field site, during the construction of the future public streets.

In addition, the Amended and Restated Reciprocal Easement Agreement will include the following easement granted by the City to the Developers include:

- A Private Utilities Easement across the future site of the Second Tranche Development in order to provide utility service to the Tranche One Development site

City and Private Developer Improvement Agreement and Right of Entry

Although the City is retaining the streets portions of the property, the Developers have submitted improvement plans for the construction of all public improvements related to the project, including streets. The improvement plans and the secured City Private Development Agreement must be executed by the Developer and approved by the Public Works Director prior to issuance of the building permit in accordance with the PD permits # PD12-019.

The City will enter into a Right of Entry to allow the developer to enter the City property to construct the street improvements.

First Amendment to Parking Agreement with Earthquakes, LLC

When the City sold the adjacent property to the Earthquakes, the City agreed that the Earthquakes would have access to 6,000 parking spaces in the remaining property for Stadium Parking and the Earthquakes are obligated to pay $100,000 per year for the parking rights. As a result, the Earthquakes and the City have a Parking Agreement that allow up to 6,000 cars to park on the City's property for Earthquake's games and events. The purchaser of the remaining property has the responsibility to provide the needed parking spaces. As the Developer is proposing to purchase approximately half of the development site, the First Amendment to the Parking Agreement decreases by half the amount of parking spaces required under the property held by the City under current Parking Agreement. Consequently, the City will only receive $50,000 for the parking rights. Though revenues from other sources are sufficient enough to not require an offsetting budget action for 2014-2015, this reduced revenue level will be taken into consideration in the development of the 2016-2020 General Fund Five-Year Forecast scheduled to be released February 2015. The Developer and Earthquakes LLC will enter into an Agreement to provide for the remainder of Earthquakes Stadium parking on the property to be acquired.

HUD Loan Agreement

As mentioned above, the City obtained a $25,810,000 HUD loan for the City's purchase of a 23.2 acre portion of the Airport West property from FMC. A payment of approximately $5 million was paid to Housing and Urban Development (HUD) toward the loan for 14.497 acres of land when the San Jose Earthquakes moved forward with construction of the stadium. A principal balance of approximately $14.7 million currently remains on the HUD land. CAP will pay $13.6 million for the remaining 8.471 acres of land. Staff has worked with HUD to allow $11.1 million be to be repaid to HUD upon sale and transfer of the property. The City proposes to retain $2.5 million in order to advance funding for a portion of the Caltrain tunnel connection. The remaining debt would be paid off over a five year period beginning in 2015-2016 in annual payments of approximately $750,000. As mentioned above, the Developer commits to repay the City for the tunnel connection as the purchase of land in the Second Tranche (Phase 3) takes place and building commences.

Additional HUD Considerations

Communities that borrow HUD funds commit to new job generation, particularly low and moderate income jobs, resulting from the use of the Federal dollars. The HUD Section 108 loan obtained in 2005 included a job generation goal of 836 jobs. More important to HUD than the number of jobs created is that 51% of the jobs generated go to low-and moderate-income people. Because the development of the Airport West property was initially linked to the development of the Airport, jobs generated through the expansion of the Airport and jobs generated on the 23.2 acres of land purchased through the HUD loan are to be counted towards the job generation goal.

Approximately 337 jobs have been generated thus far from the Airport expansion. Of those jobs, 192 jobs, or 57% of the jobs generated at the Airport have gone to persons of low-or moderate-income. It is anticipated that the bulk of jobs from the hotel and retail components of Tranche 1 First Phase of development will generate low-and moderate-income jobs. It is anticipated that a portion of the jobs generated by the Office/R&D component of the project will also be low-and moderate-income jobs. The Developers have agreed to require that the tenants that occupy the space comply with the HUD job counting requirements six months beyond the full occupancy of the Tranche 1 Phase 1 build out on the remaining 8.9 acres funded by HUD.

If the City does not meet the requirement to provide 51% of the jobs generated on site for low-to-moderate income persons HUD may require that job counting continue. If additional job counts are required, the City, not the Developers, will be responsible for working with the tenants to obtain the necessary job information. In addition, it is possible HUD may require a financial penalty as HUD's low interest loans require the generation of low and middle income jobs. The Agreement with CAP specifies that should any HUD financial penalties be imposed, the Developer will be responsible for one half of the City's penalty up to $500,000; however, the City will be indemnifying the Developer for any other liability from HUD other than failure to report jobs.

Anticipated Future Tax Revenues (Phase 1)

Based on early estimates, it is anticipated that the Phase 1 project will generate annual revenue to the City of approximately $1.6 million from property tax ($1.2 million), Transient Occupancy Tax (TOT) ($324,000), and Sales Tax ($50,000). Phase 1 is anticipated to be complete in 2016 and the City is anticipated to begin receiving revenues in 2017.

Consent of Bank of America Owner of the Series 2008F Bonds

In June, 2014, Bank of America purchased the Series 2008F Bonds in a private placement for a term of 3 years. The Series 2008F Bonds are lease revenue bonds that are structured with a lease/lease back transaction between the Authority and the City. Under this structure, the City leased the portion of the Airport West property purchased with the bond proceeds to the Authority and the Authority leased it back to the City under the General Sublease. The lease payments form the City to the Authority are the source of repayment of the Series 2008F Bonds.

One of the reasons for privately placing the Series 2008F Bonds was to facilitate the phased sale of the Airport West property since a sale of the portion of the property financed with the bonds would reduce the property under the Site Lease and the General Sublease. Accordingly, the City negotiated with Bank of America to make certain changes to the financing documents that provide for:

1. Bank of America's conditional consent to the planned sale of the property included in the first tranche, so long as all the following conditions are met:

    a. The City and the Authority are not in default under the documents governing the 2008F Bonds;
    b. The closing on the sale occurs on or before December 31, 2014;
    c. The City applies the gross sales proceeds received from the sale to redeem outstanding 2008F Bonds;
    d. The City certifies that the fair market value and fair rental value of the remaining property are sufficient to cover the remaining 2008F Bonds; and
    e. A revised General Sublease and a revised Site and Facility Lease are executed showing the revised legal description of the Leased Property with an updated title policy prepared.

A roadmap to a similar conditional consent for the sale of the second tranche of the Airport West property was also agreed to by Bank of America, subject to Bank of America's right to request such additional documentation as it may deem necessary to establish such value.

Due to the extensive number of documents required to close the proposed transaction, final close of escrow is likely to occur after December 31, 2014. The City has coordinated with Bank of America to extend the deadline for closing on the first tranche to March 31, 2015.

EVALUATION AND FOLLOW-UP

Staff will work with the Developer to facilitate the timely construction of the First Phase of development on the Airport West property. Staff will work with HUD representatives and the Developers and tenants of the buildings to ensure compliance with HUD job counting requirements. Staff will work with the Valley Transportation Authority and the Developer to assist in completing the tunnel that connects the project directly to the Santa Clara Caltrain Station.

POLICY ALTERNATIVES

The development proposal as recommended offers an opportunity to initiate speculative Office/R&D development as well as hotel and retail development on the Airport West site. The site will yield a distinctive and desirable location that combines office and commercial uses adjacent to significant recreational and transportation amenities, including the new $100 million Earthquakes Major League Soccer Stadium.

Alternative #1: Do not move forward with the proposed partial sale of the 22.815 acres of Airport West Property.
Pros: The City could potentially sell all interest in the Airport West property in December 31, 2015 as specified in the current Purchase and Sale and Option Agreements, or receive another $2 million option payment.
Cons: As the sale of the entire property at this time is unlikely, the City would risk missing substantial current development activity in Silicon Valley that would include hotel, retail and Office/R&D development. The City would not benefit from near term construction taxes, property tax, transfer tax, sales tax, and transient occupancy tax that would be generated from the anticipated Phase 1 development. The City would also not realize the much needed job generation that will come from projected development.
Reason for not recommending: Staff recommends proceeding with the proposed sale of 22.815 acres of the Airport West development to facility near term development as well as future tax revenue and job generation.

PUBLIC OUTREACH/INTEREST

This memorandum will be posted on the City's website for the December 16, 2014, City Council meeting. The Developers have complied with all public outreach requirements as outlined in the City of San Jose's entitlement process.

COORDINATION

This memorandum was coordinated with the City Attorney's Office, the Finance Department, and the Public Works Department.

FISCAL/POLICY ALIGNMENT

The project aligns with the City's Economic Development Strategy #11 "Revise Key Land Use and Transportation Policies to Reflect the new Realities for the San Jose Economy and Strategy #12 "Encourage Sporting Teams, Events, and Facilities, Professional as well as Amateur."

COST SUMMARY/IMPLICATIONS

The proposed agreement breaks the sale of the Airport West property into two tranches that are each summarized below.

Tranche 1

Anticipating a close no later than the first quarter of 2015, the 22.815 acres comprising Tranche 1 will be sold at a price of $41.31 per square foot, a price that takes into consideration that the City will retain roads and other public rights-of-way within the property. In addition, the City will receive $3.5 million from the Developers that will be paid to VTA for the construction of a subterranean walkway connecting to the nearby Caltrain station; the City will advance the remaining $2.5 million of the Developer's contribution that will be paid back in Tranche 2 described below. The $2.5 million advance is made possible by withholding a portion of the sale proceeds that would have otherwise paid down the existing HUD debt. The sale also includes the application of a $5 million credit due to the option payments previously received in 2008-2009.

Tranche 1 Line Items	**Amount ($)**
Sale of Development and Commercial Sites ($41.31* per square foot, 22.815 Tranche 1)	$41,052,562
Developer Contribution for Caltrain Connection	$3,473,000
Payment to VTA for Caltrain Connection (Includes City's $2.5 million advance for Developer's remaining contribution)	($5,973,000)
Credit for Previous Option Payment	($5,000,000)
Net Sale Proceeds Available for Debt Pay Down, Tranche 1	$33,552,562

* This amount is equivalent to the $35.83 per square foot after accounting for roads and other public rights-of-way that will remain in City control after development is complete.

The table below describes how the Tranche 1 sale proceeds would be applied toward the property's two outstanding debt obligations.

Debt Obligations	Outstanding Debt	Sale Proceeds	Remaining Debt
2008F Lease Revenue Bonds	($62,105,000)	$22,422,481	($39,682,519)
Section 108 HUD Loan	($14,706,000)	$11,130,081	($3,575,919)
Total	**($76,811,000)**	**$33,552,562**	**($43,258,438)**

Finally, the following table shows the estimated savings in annual debt service payments the City is expected to recognize after Tranche 1 sale proceeds pay down the outstanding principal. The increase in 2015-2016 is due to an estimated change in the timing of the HUD loan payments.

Fiscal Year	Debt Service Current - No Sale	Debt Service - Post Sale	Savings/(Increase)
2014-2015	2,629,572	2,347,098	282,474
2015-2016	3,232,577	3,378,047	(145,470)
2016-2017	4,091,120	3,765,303	325,817
2017-2018	5,865,986	4,032,063	1,833,923
2018-2019	6,142,318	4,146,351	1,995,967

The 2015-2019 General Fund Five-Year Forecast included the HUD and Series 2008F debt service payments in each year of the Forecast. While there was an option agreement that required the purchase of the property by December 2015, the debt service costs were assumed in the Forecast after that date because it was unknown whether the developer would exercise the option. By extending the option period from December 2015 to December 2017, the City will be required to pay the remaining debt service costs for an additional two years. These costs, however, have been built into the Forecast.

The proposed agreement also obligates the City to reimburse the Developers up to $1 million for the removal of hazardous materials and substantial underground structures from the former FMC plant. This amount can be covered with the $1.0 million Airport West Property Sale Reserve that was established in 2013-2014 with the receipt of a previous option payment received by the City.

Tranche 2

The proposed agreement allows for the Developers to exercise the option to purchase Tranche 2 on or before December 31, 2017. The tables below describe the cost implications for the Tranche 2 sale based on a $35.83 per square foot price. With the development related to Tranche 1 and a new Caltrain connection underway, it is likely that a future appraisal for acreage related to Tranche 2 will result in a higher square foot price as described above. However, the City will receive only the first $5 per square foot of the reappraisal as stated above.

Tranche 2 Line Items	**Amount ($)**
Sale of Development and Commercial Sites ($35.83 per square foot, 19.1 acres Tranche 2)	$29,810,416
Reimbursement for Caltrain Connection Advance	$2,500,000
Net Sales Proceeds, Tranche 2	$32,310,416

The table below describes how the Tranche 2 sale proceeds of $32.3 million would be applied toward the property's two outstanding debt obligations. In addition to the sale proceeds, a 2008F Bond Reserve of $1.9 million as well as a City-Wide Construction Tax and Property Conveyance Tax Fund allocation of $2.3 million (established in June 2012 to be allocated to 2008F Bond debt at time of sale to offset a portion of the forgone property sale proceeds associated with the construction of the City soccer fields on the property) are available to apply to the outstanding debt. For ease of comparison and because the Tranche 2 option to purchase could be exercised any time prior to December 31, 2017, it is important to note that the outstanding debt referenced below is the amount remaining after the Tranche 1 sale. In reality, the outstanding debt at the time of the Tranche 2 sale will be lower due to the City's ongoing debt service payments listed above.

Debt Obligations	**Outstanding Debt**	**Sale Proceeds**	**2008F Bond Reserve***	**C&C Tax Funds**	**Remaining City Obligation**
2008F Lease Revenue Bonds	($39,682,519)	$32,310,416	1,860,000	2,339,000	($3,173,103)
Section 108 HUD Loan	($3,575,919)	--	--	--	($3,575,919)
Total	**($43,258,438)**	**$32,310,416**	**1,860,000**	**2,339,000**	**($6,749,022)**

*In accordance with bond provisions, the 2008F Bond Reserve will only be applied to the remaining debt once principal and interest equal $1.86 million; in essence, the final payment.

Amendment to Parking Agreement with San Jose Earthquakes

To account for the loss of half of the available parking spaces on City property previously available for parking at the Earthquakes' new stadium, the First Amendment to the Parking Agreement with the San Jose Earthquakes will result in the reduction of parking rights payments from Earthquakes to the City from $100,000 to $50,000. Though revenues from other sources are sufficient enough to not require an offsetting budget action for 2014-2015, this reduced revenue level will be taken into consideration in the development of the 2016-2020 General Fund Five-Year Forecast scheduled to be released February 2015.

BUDGET REFERENCE

The table below identifies the General Fund revenue and expenditure appropriations that will be adjusted and created in accordance with the recommendation and the discussion included in the Cost Summary/Implications section.

Fund #	Appn. #	Appn. Name	Total Appn.	Rec. Budget Action	2014-2015 Adopted Operating Budget Page	Last Budget Action (Date, Ord. No.)
001	3359	FMC Debt Service Payments	$3,018,000	$33,552,562	IX-27	06/17/2014, Ord. No. 29431
001	NEW	Airport West Property Caltrain Connection	$0	$5,973,000	N/A	N/A
001	NEW	Airport West Property Underground Abatement	$0	$1,000,000	N/A	N/A
Total Current Funding Available			**$3,018,000**			
New Funding to be Appropriated				**$40,525,562**		
001	R130	Other Revenue	$123,343,559	$39,525,562	VI-48	11/04/2014, Ord. No. 77203
001	8422	Airport West Property Sale Reserve	$1,000,000	($1,000,000)	IX-52	06/17/2014, Ord. No. 29431

CEQA

CEQA: EIR Resolution No. 71716, File No: PP08-093 and File No: PDC09-004

/s/

KIM WALESH
Deputy City Manager/
Director Economic Development

Jennifer A Maguire

JENNIFER A. MAGUIRE
Deputy City Manager/
Budget Director

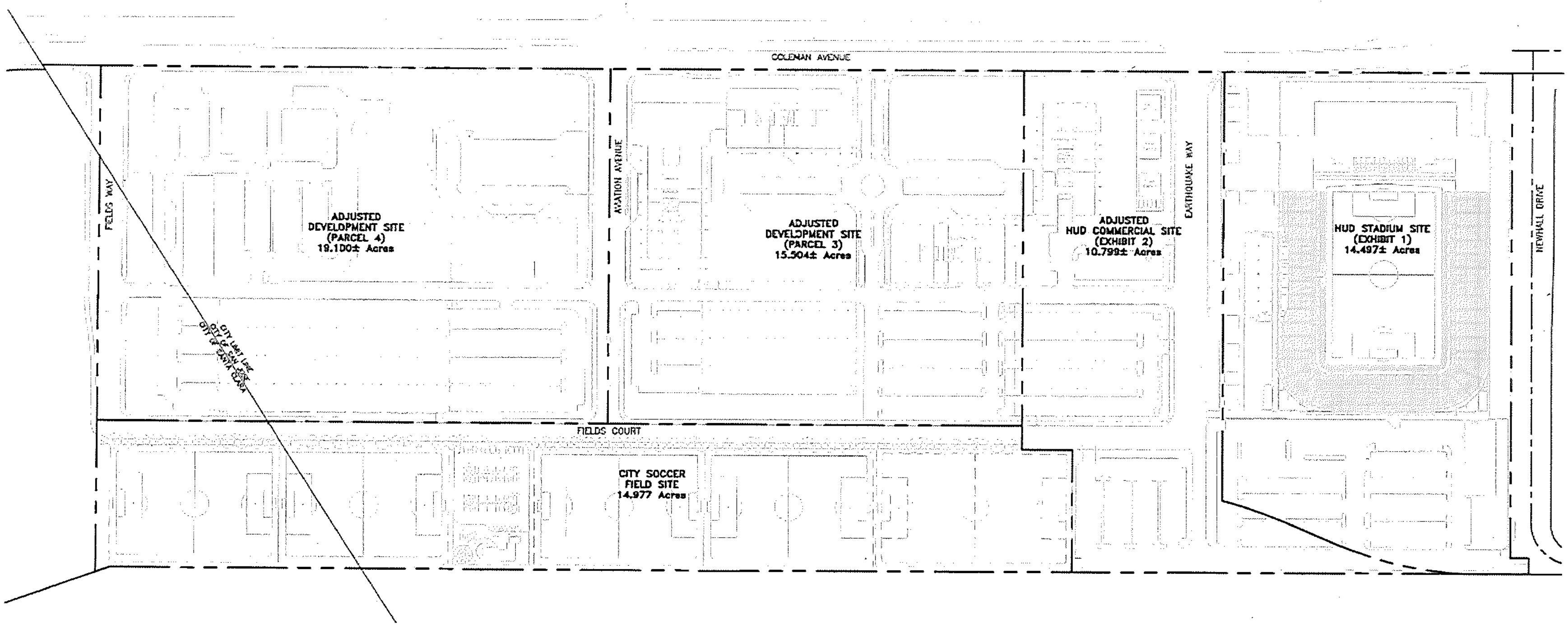
For questions, please contact Nanci Klein, Assistant Director, at (408) 535-8184.

I hereby certify that there will be available for appropriation in the General Fund in the Fiscal Year 2014-2015 moneys in excess of those heretofore appropriated therefrom at least for $39,525,562.

Jennifer A Maguire

JENNIFER A. MAGUIRE
Deputy City Manager/
Budget Director

Attachment A



Attachment B - Current Source and Use

Sources	**Agreement**
Sale of Development and Commercial Sites ($36.37 per square foot/43.56 acres)	$69,011,115
Developer purchase additional property $23 per square foot, 1.843 acres	1,846,465
2008F Bond Reserve	1,860,000
City-Wide Parks Construction Tax and Property Conveyance Tax Fund (funding set aside in 2012 to offset debt costs)	2,339,000
Option Payment Credit*	(5,000,000)
Option Payments ($1,000,000 due Dec. 2013 and $2,000,000 due Dec 2014 if the property sale is not completed).	3,000,000
Sub-total sources	**$73,056,580**
Uses (as of July 2014)	
2008F Lease Revenue Bonds	($62,105,000)
HUD Section 108 Loan	(14,706,000)
Sub-total uses	**($76,811,000)**
Potential Shortfall	**$3,754,420**

Attachment C (Coleman Highline)